United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-2550

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

BROWNING DEBENTURE HOLDERS'
COMMITTEE, et al.,

Appellants,

-against-

DASA CORPORATION and
ARTHUR ANDERSEN & CO.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR

THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF APPELLANTS

BREWER & SOEIRO
257 Park Avenue South
New York, New York 10010
(212) 777-4010
Attorneys for Appellants

Of Counsel:

Bradley R. Brewer

(Proof of SErvice Attached)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

PROCEDURAL STATEMENT

The plaintiffs below (hereafter "the plaintiffs') have appealed from two determinations below: (1) the judgment of the district court (S.D.N.Y., Owen, J.) dated October 11, 1974, and filed October 15, 1974, dismissing the complaint as to Claims 1 and 2 set forth therein and (2) an order of the district court (Owen, J.) filed October 11, 1974, denying applications by the plaintiffs for certain pretrial relief calculated (a) to reduce by approximately 80 percent the costs of taking pretrial depositions herein through the use of transcripts based upon tape recordings rather than stenographic notes and (b) to reduce both the cost and time required for further pretrial discovery herein through issuance of an appropriate pretrial order (i) removing from the action issues of fact not actually or reasonably disputed and (ii) limiting the scope of necessary discovery to the very few issues of fact as to which trial on the merits will be necessary and justified.

Three defendants are principally involved in the action below at this point: Dasa Corporation ("Dasa"), The Bank of New York (the "bank"), and Arthur Andersen & Co. ("Andersen"), (collectively, the "defendants.") Dasa and Andersen are appellees before this court. This appeal has been voluntarily dismissed as to the bank by stipulation because it is only slightly and indirectly involved in the issues of this appeal, if it is involved in those issues at all.

With respect to the pretrial procedures involved in this appeal, the bank has consented to rely upon representation through the other defendants and to be bound by this court's decision.

In a motion argued before Judges Waterman, Hays and Mulligan of this court on January 21, 1975, Dasa moved for dismissal of this appeal in its entirety and for an award of costs and attorneys' fees of the motion. That motion was denied by the panel from the bench and by an order dated January 21, 1975, without prejudice to renewal of the motion in connection with argument of the merits of the appeal. Dasa has indicated its intention to renew the motion. In opposition to the motion to dismiss this appeal thus renewed, the plaintiffs have filed a separate memorandum of law dealing with the question of the appealability of the order below here appealed from. Consequently, this brief will be addressed exclusively to the merits of the three determinations below which are the subject of this appeal.

By order dated January 7, 1975, and signed by Judge Mansfield, this court, <u>inter alia</u>, (1) authorized use of a deferred appendix pursuant to Rule 30(c), F.R.A.P., and (2) granted appellants permission to file only ten copies of their brief. Because of the deferred appendix, record notations hereafter have been made to the original record by inserting appropriate record document numbers above the line at appropriate places.

QUESTIONS PRESENTED

64*

(1)(a) Was the order below denying plaintiffs' application for (i) a pretrial order under Rule 56(d) [or Rule 16] limiting the factual issues for discovery and trial and (ii) an order permitting depositions by plaintiffs' counsel to be conducted through the use of tape recorders final and appealable to this court or reviewable by it under (A) 28 U.S.C. §1291 as construed in Gillespie v. U.S. Steel Corp., 379 U.S. 148, 152-154 (1964); (B) 28 U.S.C. §1651 (the 'All Writs Statute'); or (C) the "Offshoot Rule" of Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949)?**

(b) If so, was that order arbitrary, clearly erroneous, unreasonable, an abuse of discretion or otherwise properly subject to review and reversal by this court?

(2) Was it reversible error under Rule 56, F.R.C.P., for the district court to dismiss Claims 1 and 2 herein without either considering or ruling upon the merits of plaintiffs' allegations that the proxy materials sent to Dasa's shareholders in connection with its 1972 annual meeting contained material representations and involved material omissions which constituted violations of Section 14(a) of the Exchange Act and the Proxy Rules? 55, 71

(3) Was it reversible error for the district court to

---

* See also, 55, 56, 57, 58, 59, 60, 51, 6 , 65, 67, 72. Interlinear numbers refer to doc. numbers in index to the original record.

** This question is unrelated to the merits of this appeal and is dealt with in appellants' memorandum of law in opposition to Dasa's renewed motion to dismiss the appeal.

base dismissal of Claims 1 and 2 upon any one or more of the following conclusions:

(a) the theory, grounded in principles of state corporate law only and not upon principles of federal securities law under Section 14(a) and the Proxy Rules, that plaintiffs' claims of fraud and misrepresentation in the proxy materials for the Dasa 1972 annual shareholders' meeting were "rendered moot by the holding of the 1973 annual meeting" even though no correction of any of the alleged defects of disclosure was involved in any of the subsequent proxy materials;

(b) the theory or conclusion of Judge Griesa (i) that dismissal was appropriate and required because the court could determine on the record before it no substantial or readily calculable monetary damages flowing from the allegedly fraudulent and unlawful proxy materials distributed by Dasa's management and (ii) that the court was under no duty or obligation, imposed by Section 14(a) as interpreted in Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), and later cases, to consider the appropriateness of non-monetary equitable relief to correct any injustice resulting from the alleged statutory violations of the kind specifically suggested by the Supreme Court in the Mills decision;

(c) the conclusion of Judge Griesa that Claims 1 and 2 could properly be dismissed by the district court without deciding the "legal issue" conceded by the court to have been raised "as to whether the alleged falsity of the 1971 annual report constitutes violation of the proxy rules"?

(4) Was dismissal of Claims 1 and 2 by the district
55, 71
court based upon a substantially mistaken and erroneous interpretation by the court of Section 14(a) and the congressional policy embodied therein as interpreted by the Supreme Court in the Mills case and Affiliated Ute Citizens v. U.S., 406 U.S. 128, 153-154 (1972), and recently by this court in Schlick v. Penn Dixie Cement Corp., _____ F. 2d _____ (2d Cir. 10/31/74); N.Y.L. Jour., 11/4/74, p. 5; 1974 CCH Fed. Sec. L. Serv., Curr. Vol., ¶94,853?

THE FACTS

A. The Plaintiffs.

This is an action brought by a committee self-named the Browning Debenture Holders' Committee (hereinafter the "Browning Committee" or the "Committee"). The Committee has three members who own, collectively, $127,000 face amount of certain 6% Convertible Subordinated Debentures (the "debentures") of DASA Corporation ("DASA").[8]

The Committee has undertaken informally, since on or about February 8, 1972, and formally in this action commenced on March 30, 1972, to represent and to protect, along with their own interests, the interests of the holders of the debentures in connection with a corporate transaction which involved: (a) the proposed sale by DASA of a large number of IBM 360 computers and leases thereof for a sale price in excess of $2 million; (b) as a precondition to such sale, the solicitation by DASA of written "consent" forms from the holders of two-thirds or more of the face amount of the debentures; (c) an offer by DASA of a new and reduced "conversion price" for the debentures as an inducement to encourage the debenture holders to submit the required number of "consent" forms to DASA so that the proposed sale transaction could be consummated and DASA could thereby raise working capital which it claimed (perhaps falsely) to need very badly to support its continuing operations; and (d) DASA's 1972 annual shareholders' meeting

held on February 29, 1972, and the distribution prior thereto by Dasa of proxy materials (defined in Point IV below to include both a 1972 proxy statement and Dasa's 1971 annual report).*[1-App. A, B; 8]

Plaintiffs Roy E. Brewer and Simms C. Browning are both debenture holders and members of the Committee. Each has sued individually and on behalf of the bondholders in Claims 3, 4 and 5, none of which has been dismissed below. Roy Brewer is also a Dasa stockholder. As such, he has sued claiming Section 14(a) violations in the proxy materials for Dasa's 1972 annual meeting of stockholders in Claims 1, 2 and 5. Those two claims (on behalf of stockholders only) were dismissed below in rulings here appealed-from.[1, 8]

Affirmance by this court of those rulings would remove from this action with finality all claims asserted by or on behalf of Dasa's stockholders** and leave remaining for

---

* In opposition to plaintiffs' motion for a temporary injunction, Dasa claimed in affidavits that the sale transaction was necessary to corporate survival because it would produce desperately needed working capital. At that time, plaintiffs had no evidence to the contrary with which to support their motion. Consequently, Judge Motley denied the temporary injunction upon the ground that failure to complete the sale would seriously and irreparably injure the company. Immediately thereafter the sale was consummated and plaintiffs' appeal from Judge Motley's ruling was thus mooted. After that, plaintiffs learned that the sale transaction was calculated almost exclusively to pay off and "bail out" a Boston bank which had extended large loans to Dasa under a line of credit and that the total net contribution of the transaction to Dasa's working capital position was approximately $100,000 only. Since such a small sum was basically insignificant for working capital purposes, the basic factual premise upon which Judge Motley based denial of a preliminary injunction was false, but not known to be so at the time.

** Except for part of Claim 5 against Andersen only.

further proceedings below only claims by plaintiffs as debenture holders at the time of the computer sale transaction against Dasa, its auditor (Andersen) and the indenture trustee for the debenture holders (the bank). Such affirmance would thus (i) remove from the action below the purported "conflict" for purposes of the suit (between plaintiff Roy Brewer as a stockholder and the plaintiff Committee as debenture holders) which caused Judge Owen to deny the Committee's Rule 23 motion to be designated representatives of the debenture holders as a class in his opinion dated July 11, 1974,[63] and (ii) consequently require or make appropriate review by this court or reconsideration by the court below of the negative class action ruling presently operative.

Reversal and reinstatement by this court of Claims 1 and 2 together with the fact that (at Dasa's insistence) the entire record below has been certified and docketed on this appeal for potential review by this court would raise and present for consideration by this court on this appeal (i) the correctness below of denial to the plaintiffs of designation as class action representatives of the debenture holders under Rule 23[63] and (ii) certain related legal and pragmatic problems arising out of the fact that plaintiff Roy Brewer is (a) both a stockholder and a debenture holder suing here in both capacities and (b) a member of the Committee seeking designation as bondholder class representatives. In his class action ruling,[63]

Judge Owen indicated his limited grasp of plaintiffs' Rule 23 motion by stating incorrectly that plaintiffs had moved for designation as class representatives of both stockholders and bondholders when in fact they sought to represent the debenture holders only.[57, pp. 12, 16, 17] He based denial of the motion on (a) the false notion that there was a conflict of interest in the action on the part of Roy Brewer as both a stockholder and a bondholder even though his stockholder claims had been dismissed; (b) the false notion that plaintiff Simms Browning is in the same alleged "conflict" position as Roy Brewer even though Browning never owned any stock; (c) the false notion that a rejection by the debenture holders of the relief sought in this action on their behalf was involved in the failure by 71.3% of the debenture holders to avail themselves of an opportunity afforded by Dasa (after commencement of this suit and upon instructions from the SEC) to revoke consents to the computer sale previously given by them to Dasa even though such inaction involved (i) no indication by the debenture holders of their position on the fairness of the debenture conversion price involved (as opposed to whether or not the sale should be consummated to save Dasa from bankruptcy) and (ii) no correction by Dasa of the misrepresentations here alleged to have been made to them; and (d) the false notion that elimination of misrepresentations to the stockholders through a corrective order under Claims 1 and 2 would somehow conflict with the simultaneous elimination of misrepresentations to the bondholders under Claim 3 despite the fact that for purposes of the truthful corporate disclosure policy of Section 14(a)

the interests of <u>all</u> corporate security holders in truthful disclosure is the same, and one class of security holders could have no legitimate or proper interest in management's telling falsehoods to another class for the purpose of achieving by deception a benefit for the first class.

B. The Defendants.

The defendants in this action are Dasa, its auditor (Andersen) and the indenture trustee for the debenture holders (the bank). The appellees here are Dasa and Andersen, the bank having been removed by stipulation. [1, 8]

C. The Claims Stated.

Claim 1. In Claim 1 [complaint, pars. 17-20] [1, 8] plaintiff Roy Brewer as a stockholder alleges violations of Section 14(a) and Proxy Rule 14a-9 in Dasa's 1972 proxy statement. [1-App.B] For present purposes, the alleged material defects of disclosure therein include the following: (1) misrepresentation of Dasa's financial condition in general through gross understatement of the severity and immediacy of its shortage of working capital and its need to generate immediate cash through the proposed sale of computers; (2) misrepresentation of the severity of its cash and working capital crisis; (3) misrepresentation of the degree to which completion of the proposed computer sale would solve or alleviate the inadequately disclosed working capital problems; (4) failure to disclose that a proposed new conversion price would be offered to the debenture holders and that completion of the sale would result in a reduced conversion price

and a commensurate "dilution" of the shareholders' equity in Dasa; (5) failure to disclose that the new conversion price would be selected by Dasa's management without the benefit of advice from an independent consultant concerning what price or prices would be fair and equitable to both shareholders and debenture holders in the circumstances; (6) failure to disclose that selection of a new conversion price by Dasa's management (officers and board) would involve on its part a direct conflict of interest between (i) the interests of the shareholders in keeping the conversion price as high as possible and (ii) the interest of the bondholders in having the conversion price reduced at least low enough to have some immediate effect upon the market price of the debentures; (7) failure to disclose that the plaintiff Committee had advised Dasa prior to the annual meeting that a law suit seeking reduction of the new conversion price to achieve fairness and equity would be commenced unless the new price was either approved as fair by an independent consultant retained for the purpose or reduced to a point between $6.00 and $12.00;* (8) a false or materially misleading statement to the effect that completion of the proposed computer sale would satisfy Dasa's working capital needs and thus solve its cash shortage and credit problems for the "forseeable future"; and (9) creation of a false impression that the computer sale would provide reasonable assurance that Dasa would be unlikely to

---

* The new conversion price offered and later effectuated was $21.00. The previous price was $42.42. The market price of Dasa's common stock was then around $4.00. It is now approximately 50 cents.

default in the "forseeable future" on its debt obligations and be cast into bankruptcy.*

Claim 2. In Claim 2 [complaint, par. 21][8] plaintiff Roy Brewer as a stockholder alleges violations of Section 14(a) and Proxy Rule 14a-3(b) in Dasa's 1971 annual report, which was distributed prior to Dasa's 1972 annual meeting and is included in the term "proxy materials" used herein. [See Point IV below.] The alleged material defects of disclosure therein include the following:

1-App.C

(1) the statement in the President's Letter of Richard A. Reichter (page 1) that "during the past fiscal year [fiscal 1971], the financial position of our Company has been . . . significantly improved," which the complaint alleges to have been false, inaccurate and misleading because (i) in fact the financial statements indicate (to an experienced securities analyst, but probably not to a nonexpert reader or shareholder) that the corporation's financial position had in fact substantially worsened or deteriorated during such fiscal year and (ii) no statements were made in that letter which qualify or explain that statement in such a way as to make it not misleading under the circumstances [par. (21)(b)2];

---

* For a more complete description of the claims stated and plaintiffs' position with respect thereto in documents included in the record on appeal, see the following: (1) First Amended Complaint, [Index No. 8] Claim 1 (pars. 17-20, pp. 25-32); Claim 2 (par. 21, pp. 33-34), Claim 3 (par. 22, pp. 35-45), Claim 4 (pars. 23-25, pp. 46-47); Claim 5 (pars. 26-29, pp. 48-49); (2) plaintiffs' memorandum in support of their Rule 23 motion, dated 6/5/73 [Index No. 25 & 26] pp. 7-27; and (3) plaintiffs' memorandum in support of their Rule 56 motion re Claims 1 & 2, dated 2/21/73 [Index No. 39], pp. 7-31.

(2) the exception to (or "qualification" of) the certification opinion of Arthur Andersen (Auditor's Report, page 13) in which Dasa's independent certified public accounting firm refused to certify the existence of a major asset of the company listed at a value of $1.5 million on the balance sheet, which the plaintiffs allege to have been "hidden," "obscured" and deceptively presented; and

(3) the inclusion in the "Consolidated Balance Sheets" (page 4) of an asset valued at $1.5 million identified as "Excess of Purchase Price Over Net Assets Acquired (Notes 1 and 3)," which plaintiffs allege to have been nonexistent, imaginary and misleading in character, contrary to good and generally-accepted accounting principles, and seriously misleading in that it served to obscure and misrepresent the true financial condition of the corporation by showing assets of approximately $12.3 million instead of $10.8 million on 10/31/72, an exaggeration of approximately 14% which would not have been evident to anyone but a trained financial analyst reading the annual report; plaintiffs say that the difference between $12.3 million and $10.8 million in assets was particularly significant in this annual report distributed in connection with the 1972 proxy statement because the proposed sale of computers for $2.4 million represented a disposition of physical assets amounting to 22% of the smaller figure as against 19% of the larger one.

Claim 3. In Claim 3 the plaintiff Committee, together with and represented by Roy Brewer and Simms Browning as debenture

holders, alleges violations of Section 14(a), Proxy Rules 14a-9 and 14a-3(a), and the Trust Indenture Act of 1933 in a "solicitation letter" dated March 9, 1972, sent by Dasa to the debenture holders soliciting their collective proxy "consent" to an amendment of the trust indenture necessary to consummate the computer sale transaction contemplated by an agreement entered into by Dasa in December of 1971 and described briefly in its 1972 proxy statement to stockholders.[1-App.A] The solicitation letter was a proxy solicitation covered by Section 14(a) and the proxy rules. In order to complete the proposed sale, it was necessary for Dasa to obtain an amendment to the indenture consented to by holders of at least two-thirds of the aggregate principal amount of the debentures. The merits under Section 14(a) of the allegations of defective disclosure set forth in Claim 3 need not be ruled upon on this appeal, since that claim was not dismissed below. The contents of the solicitation material sent to the debenture holders are, however, extremely relevant to the issues of this appeal because plaintiffs maintain that the solicitation letter, also sent by Dasa management under the Proxy Rules but to different security-holders, demonstrates the materially false and deceptive character of the shareholder proxy materials involved in Claims 1 and 2 and thus proves out of Dasa's own corporate "mouth" the merits of those claims and Roy Brewer's entitlement to relief under Section 14(a) with respect to them. Plaintiffs maintain that the shareholder proxy

materials presented a false and deceptively "rosy" picture of Dasa's financial condition, whereas the bondholder solicitation letter (written after plaintiffs had been in communication with the SEC's staff) presented a dark and gloomy picture of the financial situation that contrasted completely with the story told only a few weeks earlier to the stockholders. Both of those two conflicting descriptions were based upon the same corporate financial statements audited by defendant Andersen.

Plaintiffs thus maintain that the negative picture of Dasa's financial status set forth in the March 9 solicitation letter came much closer to the truth than the shareholder proxy materials did but involved, nevertheless, the material defects of disclosure set forth in Claim 3, the main elements of which can be briefly summarized as follows: (1) failure to disclose the fact that the proposed new conversion price of $21.00 offered in the solicitaiton letter to replace the "old" price of $42.42 was selected by Dasa's management (its board upon recommendations from its president and financial vice president) (i) without the aid of advice from an independent consultant concerning the fairness thereof and (ii) upon the biased assumption on the part of the board that it owed a duty to the stockholders who elected its members to keep the conversion price as high as possible and owed no countervailing duty to the debenture holders to offer them a fair and equitable price; (2) failure to disclose that the proposed new price of $21.00 was selected

by Dasa's board without regard to whether it was or was not a fair price based upon reasonable principles of financial analysis; (3) failure to disclose that, as representatives elected by the shareholders only and as substantial holders of common stock and options thereon, Dasa's management (officers and board members) was in a serious and substantial conflict of interest situation vis-a-vis the debenture holders with respect to the selection of a proposed new conversion price; (4) failure to explain how the figure of $21.00 was arrived at, i.e., what the rationale for it was and how the conflicting interests of shareholders and bondholders had (or had not) been considered; (5) failure to disclose the fact that the main benefit from the proposed computer sale would be to a Boston bank, which would be paid immediately approximately $800,000 representing the full amount of loans made by it to Dasa on a line of credit; and (6) failure to disclose that the net contribution of the transaction to Dasa's working capital crisis would be negligible, since only approximately $100,000 in cash would remain for use by Dasa after creditors were satisfied at the closing from the proposed $2.35 million proceeds from the computer sale. As part of the allegations of Claim 3, plaintiffs also maintain that Dasa management breached fiduciary duties to the debenture holders by failing to consider their interests adequately or reasonably in selecting the proposed conversion price of $21.00.

Claim 4. In Claim 4 the plaintiff bondholders allege that the defendant bank, as trustee for the debenture holders

under the operative indenture, violated its fiduciary obligations to them in connection with the computer sale transactions by (i) failing to intervene with Dasa management on their behalf on the conversion price issue and (ii) failing even to notify them of the conflict of interest on the part of Dasa management, of the fact that their interests were not considered by Dasa in selecting the conversion price, or of the fact that the price selected was grossly unfair to them and entirely unrelated to their potential (but never realized) bargaining position with Dasa management.

Claim 5. In Claim 5 Roy Brewer alleges as a stockholder that Andersen is liable for violations of Section 14(a) and Proxy Rule 14a-3(b) involved in the financial statements contained in Dasa's 1970 and 1971 proxy materials, and the plaintiff bondholders (the Committee, Roy Brewer and Simms Browning) allege similar violations in the financial statements incorporated in the 1972 solicitation materials sent to the bondholders. (See complaint, pars. 26-29).

D. The Decision Below Dismissing Claim 1 and Claim 2.

The decision below to dismiss Claims 1 and 2 was rendered by Judge Griesa and dated September 27, 1973.[55] Thereafter the action was reassigned to Judge Owen, and he directed entry of the judgment[71] which made the dismissal final and from which this appeal is taken. Judge Griesa's opinion presents a summary outline of the main factual events involved in this action as of its date.

For present purposes the most significant aspect of the September 27 opinion[55] is the court's failure or refusal to consider or to rule upon the merits of any of plaintiff Roy Brewer's allegations of defective disclosure made in Claims 1 and 2 and its decision, instead, to base dismissal upon its acceptance of Dasa's collateral argument that the conduct of Dasa's 1973 annual meeting and the election at that time of the same slate of directors purportedly elected at the challenged 1972 meeting rendered "moot" Roy Brewer's claims that shareholders' proxies were solicited in 1972 in violation of Section 14(a) "because of the fact that a 1973 annual meeting of Dasa has been held, before which new proxy material and a new annual report were circulated to the shareholders" (Opinion, p. 13) and "it would be an obvious absurdity to order revision of the 1972 proxy material and the holding of a new 1972 annual meeting" (Op., p. 14) even if the 1972 proxy materials were in fact fraudulent and materially deceptive in violation of Section

14(a) and no correction of the unlawfully defective 1972 proxy materials was made in the 1973 shareholder materials. Clearly the premises of that reasoning raise serious questions with respect to the meaning and effect of Section 14(a) and the proxy rules and, if accepted by this court, would create severe procedural problems hereafter in all actions under that statute because plaintiffs' counsel and the district courts would be forced either (i) to obtain definitive rulings (including appeals) on alleged proxy violations before the next meeting of shareholders (at most 12 months later) or (ii) to enjoin all subsequent and potentially "mooting" shareholders' meetings pending the obtaining of such rulings. It is extremely doubtful whether, as a practical matter, either the federal courts or the corporate defendants involved could live comfortably with the burdens thus inevitably imposed by the practical consequences of Judge Griesa's reasoning.

Secondarily and by way of dictum or alternative justification for its ruling, the district court concluded that Claims 1 and 2 should be dismissed because the court could ascertain no calculable monetary damages resulting to Roy Brewer as a stockholder or to all of Dasa's stockholders who received the 1972 proxy materials from any misrepresentations or deceptions in violation of the statute that may have been involved in the questioned proxy materials. Nowhere in its opinion does the district court either cite or discuss the implications for purposes of this ruling of the leading supreme

court cases under Section 14(a) (Mills, Borak and Affiliated Ute Citizens) or the express language in Mills instructing the lower federal courts to render equitable relief appropriate to remedy proxy violations even in the absence of discernible or measurable monetary damages, lest the prophylactic purpose of Section 14(a) be completely frustrated in a large number of cases involving substantial defects of disclosure. Plaintiffs quite understandably take the position that Judge Griesa's reasoning in this respect is plainly erroneous and directly contrary to the statutory purpose of Section 14(a) as authoritatively defined by the Supreme Court in Mills (and related subsequent cases) and recently by this court in Schlick v. Penn Dixie Cement Co., supra.

Indeed, the reasoning of Judge Griesa below in this case on the absence of monetary damages closely resembles that of Judge Metzner reversed unanimously by this court in Schlick. Here Judge Griesa could discern no injury resulting from the alleged proxy violations except for the fact that the corporate shareholders might have been lied to and deceived about the financial condition of their company and the prospective benefits (if any) to be derived from the proposed sale of virtually all of its remaining physical assets, a set of circumstances about which the shareholders might have been able to do very little except worry if they had been told the true facts* and upon which the court could see no way of placing a specific monetary value

---

* Plaintiffs contend that Dasa violated Section 14(a) by failing to include the proposed sale as an item to be voted upon by proxy at the 1972 meeting.

as "damages."* In Schlick, Judge Metzner dismissed the proxy violation claims because he could see no "allegation of injury . . . caused by the proxy violations, aside from that claimed to flow from the" allegedly unfair securities exchange ratio involved in the related 10(b) claims. In this court's view the district court "seemed to be saying" in that case, as Judge Griesa clearly did in the present one, "that the appellant failed to show that the appellees' misstatements or omissions contributed to the kind of injury which the federal securities laws were intended to redress." In both cases the district court clearly failed to distinguish between the purposes of Section 10(b) and the nature of private claims thereunder (in which monetary damages appropriately "caused" are a necessary element) and those of Section 14(a) and the nature of private claims thereunder (in which, the Supreme Court expressly held in Mills, monetary damages are not a necessary element of a valid federal claim for relief and need not be alleged or proved in all cases). If the reasoning of Judge Metzner was error in Schlick the same reasoning by Judge Griesa is equally so and must be reversed.

It should be noted that the reasoning of Judge Griesa below parallels that of Judge Metzner held erroneous in Schlick in still another respect, this one relevant to the

---

* Perhaps the court might find certain 14(a) violations to involve breach of fiduciary duties by the responsible corporate officers and directors upon which derivative recovery against them individually might be based on behalf of the corporation.

present Claim 3 of proxy violations in the bondholder solicitation materials. In Schlick this court held it error for the district court to accept the defendants' argument that no valid claim for relief under the securities laws was stated with respect to the unfairness of the corporate transaction there involved because the defendants controlled sufficient proxy votes to force completion of the transaction even if it was palpably unfair and inequitable and thus deserving of correction under state law equity principles, which the district court refused to apply on a "pendent jurisdiction" basis. Here, some time after the March 9 solicitation letter was sent,and,at the insistence of the SEC, Dasa sent a letter to the bondholders offering them an opportunity to revoke written proxy "consents" previously submitted by them. But in so doing it did not correct any of the main defects of disclosure here alleged in Claim 3. After receipt of such revocations as were received in response to its second letter, Dasa still had in its possession more than enough proxy "consents" to effect the necessary indenture amendment and complete the proposed computer sale regardless of whether or not the conversion price offered was completely unfair and grounded in an unlawful conflict of interest on the part of Dasa's management in fixing it.* Judge Griesa mistakenly relied upon the possession of such consents and the assumed irrelevance of an unfair conversion price as crucial facts below.

---

* Four percent more votes (71.3%) than the indenture required (66-2/3%). Since the total number of holders was between 400 and 500, the margin in holders was not great.

Thus even though the merits of Claim 3 are not formally presented to this court on this appeal, the decision appealed from does contain a clear-cut error of law bearing directly upon the merits of that claim which is closely related to the dismissed claims, which is likely to have a significant and improper adverse effect upon plaintiffs' interests in the further prosecution of this action below, and which this court should therefore undertake to correct on this appeal consonant with its decision in the Schlick case.

POINT I

THE ORDER BELOW WAS ARBITRARY, UNREASONABLE AND CLEARLY ERRONEOUS. IT IS PROPERLY SUBJECT TO REVERSAL BY THIS COURT.

Denial of the procedural relief requested by the plaintiffs[64*] had or will have the following consequences:

(1) It left the action, for no good reason, cluttered and complicated by a large number of factual issues arising out of allegations in the complaint, items of plaintiffs' notice to admit, and items of plaintiffs' Rule 9(g) statement which are not actually or reasonably disputed by the defendants. It is fair to say that 90% or more of the facts involved in this case are not actually or reasonably in dispute.

(2) Denial below of plaintiffs' request for a pretrial order under Rule 56(d) or Rule 16 identifying those facts and removing them from the case will have the effect, unless reversed by this court, of forcing counsel to devote hundreds of hours of easily avoidable time in nailing the undisputed facts down in pretrial discovery.[55,63,64] After that many more unnecessary hours on the part of counsel and the court will be devoted at trial to establishing those facts on the trial record. All of that really pointless effort could be knifed through and precluded by a modest but prompt amount of effort on the part of the trial court at this stage of the case by its simply adopting the procedural steps proposed in plaintiffs'

---

* 38, 39, 45, 46, 47, 49, 52, 54, 55, 57, 58, 59, 60, 63, 64, 65, 66, 67.

application in this connection to the court below.* Plaintiffs' proposal parallels very closely the procedure regularly employed by Judge Pollack of the Southern District of New York and recently described by him in two articles: 50 F.R.D. 451 and New York Law Journal (4/2/72, p. 1). It also closely resembles the procedure under Rule 56(d) vigorously urged by a panel of the District of Columbia Circuit in National Life Insurance Co. v. Silverman, 454 F.2d 899 (1971).

(3) Because of the otherwise avoidable effort that will be required, it will make the case take much longer to come to trial and much longer to try than would be the case if plaintiffs' application had been granted.

(4) It will cause the out-of-pocket costs of both plaintiffs and defendants for deposition and trial transcripts to be much greater than they need to be.

(5) It will cause the costs of deposition transcripts prepared by a court stenographer to be at least six times higher than they would be if plaintiffs' application for an order authorizing transcripts based upon multiple tape recordings had been granted.

(a) Denial of the pretrial order requested below.

The undesirable and readily avoidable consequences of that ruling are indicated above.

The fact that the procedures proposed in plaintiffs' application below are reasonable, effective and calculated to

---

*38, 39, 45, 46, 47, 52, 54, 55, 57, 58, 64, 65, 66 (p. 22)

save much time and effort of court and counsel is demonstrated by the experience of District Judge Milton Pollack described in the two articles cited above. Plaintiffs' counsel is not merely theorizing in this connection. Those procedures have been proven effective dozens (if not hundreds) of times in Judge Pollack's courtroom.[66-App.] This court is probably well-aware of the efficacy of such procedures in the able hands of Judge Pollack.

It cannot be reasonably denied that the positive duty imposed upon district judges by Rule 56(d) is at present largely ignored in this circuit, with the result that the rule is basically a dead letter and its potential benefits are not available to parties or their counsel. That state of affairs is patently indefensible --- so much so that the need for correction through an authoritative reported decision by this court would seem to be self-evident and unavoidable. Clearly this appeal presents this court with an appropriate opportunity for such a ruling. See: National Life Insurance Co. v. Silverman, supra; plaintiffs' moving affidavit below dated 6/12/74;[64] Rule 9(g) statements filed by plaintiffs[45, 46] and Dasa[41] below with respect to Claims 1 and 2; plaintiffs' proposed findings of fact with respect to Claim 3[65] served on defendants' counsel on 4/19/74 and filed below.

(b) Denial below of permission to prepare deposition transcripts from multiple tape recordings.

The undesirable and unreasonably burdensome effects of

that ruling[64] are indicated above.

Plaintiffs' counsel recently employed the procedure proposed in their motion in a case tried in the Southern District with complete success and absolutely no problems, despite the fact that the action in which the procedure was used was bitterly and grudgingly contested by opposing counsel on virtually every conceivable issue. So plaintiffs' counsel knows from recent experience (1) that the proposed tape recording procedure works, and works very well and (2) that the possible problems described by Dasa's counsel are mere unfounded conjecture and nothing more.

It is significant that tape recorded depositions and taped (or videotaped) trials present two different sets of problems. In the case of a deposition, the entire focus is upon the answers of the witness to the questions asked as recorded on the written transcript. Issues of credibility and nuances such as tone of voice and facial expression are irrelevant. The problem of multiple and possibly unidentifiable attorneys' voices making objections and lengthy arguments is almost never involved in a deposition, as it might be in a tape-recorded trial.

Accuracy of the transcript resulting from multiple recordings is easily checked, although the experience of plaintiffs' counsel is that issues of this kind simply do not arise. Either two or three simultaneous tapes are prepared at the depositions. Each tape recorder contains a highly sensitive

microphone, is about the size of a cigar box, sits unobtrusively and unthreateningly before the witness, and involves no microphones at all. If two tapes are made, one is given on the spot to counsel for the witness or a designated opposing party, and one is kept by deposing counsel for use in having the transcript typed-up. If three tapes are made, one is sealed on the spot and filed with the court or kept in a designated depository for future reference if required. It is thus readily apparent that any conceivable inaccuracy or omission in the typed transcript could be easily checked and corrected. In fact, the accuracy of the transcript could be more easily checked than one prepared by a court stenographer.

Moreover, any party or counsel with fears unresolved by the circumstances described above would always be free to have the deposition testimony recorded by a stenographer at its own expense.

In the circumstances it is impossible for plaintiffs' counsel even to imagine how any unfair burden or inconvenience could possibly be imposed upon the defendants in this case from adoption of the tape recorded deposition proposal. See, Lucas v. Curran, 62 F.R.D. 336, 339 (E.D. Pa., 1974, Green, J.), and cases cited therein. In a letter to Judge Owen below dated 7/19/74, plaintiffs stated their willingness to accept as a modification of the procedure proposed in their motion all or such part of the procedure approved by the court in Lucas as Judge Owen might wish to adopt.

POINT II

DISMISSAL OF CLAIMS 1 AND 2 BELOW WAS COMPLETELY CONTRARY TO THE MOST ELEMENTAL PRINCIPLES OF LAW UNDER RULE 56, F.R.C.P., BECAUSE THE DISTRICT COURT DISMISSED THE CLAIMS AND AT THE SAME TIME (1) HELD THAT MANY HOTLY CONTESTED ISSUES OF FACT WERE RAISED BY THOSE CLAIMS, (2) HELD THAT ISSUES OF LAW WERE PRESENTED WHICH THE DISTRICT COURT DID NOT WISH TO DECIDE, AND (3) REFUSED TO CONSIDER OR RULE UPON THE MERITS OF ANY OF PLAINTIFFS' ALLEGATIONS OF MATERIAL MISREPRESENTATIONS AND OMISSIONS IN THE INSTANT SHAREHOLDER PROXY MATERIALS.

Rule 56(c) provides that summary judgment may be granted only where the record before the court shows conclusively "that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." It is axiomatic, therefore, that summary judgment cannot be granted (1) where material and genuine issues of fact are presented by the record which the court cannot (or in its discretion will not) resolve on the basis of the paper record or (2) where issues of law exist which require a trial for effective clarification of the record and decision by the district court. Sartor v. Arkansas Natural Gas Corp., 321 U.S. 620 (1944).

In his decision below,[55] Judge Griesa declined or refused to rule upon the merits of a single one of plaintiffs'

allegations of material misrepresentation in and omission from the instant shareholder proxy materials. Clearly that omission by the court left a large bundle of unresolved issues of mixed law and fact in the case which precluded issuance of summary judgment for the defendant. Moreover, the court's opinion itself admits that those allegations are "hotly" contested by Dasa and thus open and undecided. In addition, the opinion identifies but refuses to decide a material question of law with respect to the alleged violations in Dasa's 1971 annual report.

In the circumstances presented by this record, there was a clear and palpable failure by the court below to comply with controlling principles of law under Rule 56.

POINT III

ACCEPTANCE BY THIS COURT OF DASA'S "MOOTNESS" ARGUMENT (A) WOULD BE COMPLETELY INCONSISTENT WITH THE PURPOSE OF SECTION 14(a) OF THE EXCHANGE ACT AND WITH THE HOLDING OF EVERY RECENT OPINION INTERPRETING THAT STATUTE AND (B) WOULD ESTABLISH IN THIS CIRCUIT A GIGANTIC AND PROFOUNDLY PERNICIOUS LOOPHOLE IN THE FEDERAL LAW GOVERNING SOLICITATION OF PROXIES.

Dasa's argument concerning the alleged "mootness" of Claims 1 and 2 was accepted by Judge Griesa below as the main basis for dismissing those claims.* The thrust of that argument is this: assuming that material defects of disclosure were made in proxy materials for a corporate annual meeting in violation of Section 14(a), any federal claim for relief based upon such violations is rendered moot if the corporation holds a subsequent shareholders' meeting and reelects the same directors, even though no correction of the original misrepresentations was made in connection with the subsequent meeting or meetings. In other words, the holding of a later shareholders' meeting operates, as a matter of law, like a general pardon

---

* The other ground for dismissing those claims was Judge Griesa's conclusion that the award of monetary damages would not be proper under either of those claims. Cf. duPont v. Wyly, 61 F.R.D. 615, 629 (D. Del., 1973, Stapleton, J.), citing J.I. Case v. Borak, 377 U.S. 426 (1964). Plaintiffs argue that conclusion to have been based upon a failure to distinguish between a 14(a) claim and a 10(b) claim and thus contrary to the recent holding of this court in Schlick v. Penn Dixie Cement Corp., ____ F.2d ______ (2d Cir. 10/31/74); CCH Fed.Sec.L. Serv., Curr.Vol. ¶94,853. See also, Fox v. Prudent Resources Trust, _____ F.Supp. _____ (E.D. Pa., 9/18/74, Luongo, J.), CCH Fed.Sec.L.Rep., Curr. Vol. ¶94,826 (Held: a 10(b) injunctive claim is validly stated even though no damages were alleged.)

or release which erases the earlier violations of federal law without trace and beyond the power of a federal court to award appropriate relief under the statute.

Obviously all persons, animate and corporate, who violate federal laws would like to share with former President Nixon the chance to have the record of violations and possible violations swept clean by some sort of pardon or blanket amnesty. Although he was apparently advised by some to do so, even Mr. Nixon as President lacked the gall necessary to grant a pardon to himself. Yet that is what Dasa argued successfully before the court below it has the right and power to do.

By simply holding another shareholders' meeting before a stockholder obtains a federal court ruling on alleged violations of the proxy statute, corporate management responsible for committing the violations can absolve itself and the corporation of all accountability in a federal court action. That is the essence of Dasa's "mootness" argument, and it is patently absurd. How and why Judge Griesa failed to perceive its absurdity and accepted this bizarre and perverse argument is a complete mystery. The Supreme Court decisions in Borak, Mills and Affiliated Ute Citizens were cited to him, but his opinion contains neither any discussion of applicable law under Section 14(a), nor any consideration of plaintiffs' allegations of statutory violation.

It is clear that if this court were to accept Dasa's "mootness" argument, its decision would engraft onto the federal

law under Section 14(a) by judicial "legislation" (disguised as statutory interpretation) a gigantic loophole or exception of which corporations will be quick to take full advantage. When taxed by security holders with material violation of the proxy statute, management will simply hold quite promptly another meeting and have a second or ratifying vote on all action taken pursuant to the challenged proxy materials (without correcting any of the earlier challenged representations). Then they will cry "mootness" in the ensuing federal action and have the action dismissed, thus avoiding accountability for any statutory violations, turning completely on its head the maxim of equity that "there is no wrong without a remedy," and making a complete mockery of Section 14(a), the congressional purpose embodied in it, and the decisions of the Supreme Court and this court interpreting it.

There is nothing in the statute, or in any SEC regulation under it, or in any federal court decision construing it that even remotely suggests support for the interpretation argued here by Dasa. Nothing in the law states or implies that a security holder claiming proxy law violations in a federal action must obtain a definitive ruling that the statute was violated before the corporation holds another meeting, at the risk of being thrown out of court if he fails to do so. Clearly this court should think long and hard before inserting such a pernicious and nullifying interpretation into the federal law under Section 14(a).

No authority was cited by Judge Griesa in his opinion for the novel construction he gave to the statute. Dasa's counsel cited only one case to him. He did not cite it in his opinion, we submit for good reason. That decision, Phillips v. The United Corp., 5 SEC Jud. Dec. 758 (S.D.N.Y., 1948), appeal dismissed sub nom Phillips v. SEC, 171 F.2d 180 (2d Cir. 1948), did not involve the federal proxy statute at all, was decided exclusively on the basis of a rather questionable construction of principles of state corporate law, has been cited hardly at all since it was decided, and was decided some 15 years before a private remedy for violation of Section 14(a) was first recognized by the federal courts.

It is plainly inconsistent with the proper functions of a federal court under Rule 56 for claims to be dismissed without the court having given any consideration at all (a) to the facts alleged to have constituted a violation of federal law or (b) to the applicable principles of law alleged to have been violated by those facts.

POINT IV

THE COMPLAINT ALLEGES IN CLAIM 2 SUBSTANTIAL DEFECTS OF DISCLOSURE IN DASA'S 1971 ANNUAL REPORT VIOLATIVE OF SECTION 14(a) AND PROXY RULE 14a-3(b) WHICH WERE NEITHER DISPROVED BY DASA'S MOVING PAPERS NOR FOUND BY THE DISTRICT COURT TO BE WITHOUT MERIT. PROXY RULE 14a-3(c) DOES NOT PRECLUDE A PRIVATE CLAIM UNDER 14(a) FOR MISREPRESENTATIONS MADE IN A NONFILED ANNUAL REPORT AND NOT EXPRESSLY PROSCRIBED BY REGULATION 14A.

(a) The "Proxy Materials" Involved

In this brief the term "proxy materials" is used to include both (1) the "proxy statement" 1-App.B and voting card distributed by Dasa to its shareholders in connection with its 1972 annual meeting and (2) Dasa's 1971 annual report 1-App.C distributed by it simultaneously with the proxy statement and considered by the shareholders in connection with their votes, by proxy or in person, at the 1972 annual meeting.

The "Proxy Rules" (SEC Regulation 14A under Sec. 14(a)) define the term "proxy statement" in Rule 14a-1 to mean "the statement required by Rule 14a-3(a), whether or not contained in a single document." Rule 14a-3(a) requires that each solicitation of proxies covered by the Rules be accompanied or preceded by a "proxy statement" containing the information required by Schedule 14A. Thus "proxy statement" is a term of art under the Proxy Rules meaning a statement (usually so-labelled) as required by Schedule 14A and by the applicable

Proxy Rules.

A proxy statement is deemed by the SEC to be "soliciting material" officially "filed" with it and subject to review and clearance (but not approval) by its staff before distribution. Rule 14a-3(c). An "annual report" must be distributed to the shareholders along with or prior to the proxy statement under Rule 14a-3(b), and its contents must conform to that rule. However under Rule 14a-3(c), seven copies of the annual report must be "mailed to the Commission, solely for its information" but that document "is not deemed to be 'soliciting material' or to be 'filed' with the Commission or subject to this regulation otherwise than as provided by this rule, or to the liabilities of Section 18 of the [Exchange] Act, except to the extent that the issuer specifically requests that it be treated as a part of the proxy soliciting material or incorporates it in the proxy statement by reference."

Thus, Rule 14a-3(c) purports to give the soliciting corporate management an option whether or not to have the annual report officially "filed" and reviewed by the SEC staff. In the present case, as is usual, the 1971 annual report was not officially "filed" or incorporated by Dasa as part of the 1972 proxy statement; nor was it reviewed by the SEC staff. It was, however, subject to the express requirements of Rule 14a-3(b) (which plaintiffs allege to have been violated) and considered by the Dasa shareholders in connection with the solicitation

of their proxies for the 1972 annual meeting. Consequently, the term "proxy materials" is used here to indicate the overall "package" of materials received by each Dasa stockholder in early 1972, including both the "proxy statement" and the annual report.

In Claim 1 the complaint alleges that there were false and misleading statements in and material facts omitted from Dasa's 1972 proxy materials in violation of Section 14(a) of the Exchange Act and Rule 14a-9 thereunder. The alleged defects of disclosure set forth in that claim involve the proxy statement and the form of proxy sent by Dasa. Claim 2 alleges violations of Section 14(a) and Rule 14a-3(b) through material misstatements in and omissions from Dasa's 1971 annual report.

(b) <u>The Violation Alleged in the 1971 Annual Report.</u>

In addition to alleging, in Claim 2, specific violations of Section 14(a) and Proxy Rule 14a-3(b) in Dasa's 1971 annual report,[1-App.C] plaintiffs also make, in this appeal, a direct frontal attack (if such be necessary to assertion of all of their 14(a) claims directed at the annual report) upon the validity of that portion of Rule 14a-3(c) cited above which purports (or may be read) to place corporate annual reports in a legal status (designated "not filed" and "not soliciting material") (a) separate and distinct from that of proxy statements and (b) beyond the application of either (i) the Proxy Rules (except as expressly provided therein) or (ii) the express liabilities set forth in Section 18 of the Exchange Act,

unless the corporation expressly elects to incorporate them by reference into the proxy statement or to have them treated as part of the formally "filed" soliciting materials.*

The slow and laborious history of recognition by the federal courts of private claims for relief under the federal securities laws is relevant, but need not be discussed at length here. It was not until many years after passage of the Securities Act and the Exchange Act that <u>any</u> private claim thereunder was recognized. It was not until <u>Dann v. Studebaker</u>, 288 F.2d 201 (6th Cir. 1961), that a claim under Section 14(a) was discussed in a reported decision, and not until <u>J.F. Case v. Borak</u>, 377 U.S. 426 (1964), and <u>Mills</u> six years later that such a claim was recognized and given some definition by the Supreme Court.

The private claim and remedy under Section 14(a) recognized in <u>Borak</u>, <u>Mills</u>, and <u>Affiliated Ute Citizens v. U.S.</u>, 406 U.S. 128 (1972), is rooted in the statute itself and in the Congressional policy embodied in it of furthering corporate democracy and the protection of the investing public by insuring

---

* Although the "annual report" required by Rule 14a-3(b) to be distributed to security holders may be deemed "not filed" by the SEC for administrative purposes, the corresponding "annual report" required by Rule 13a-1 is required to be and deemed by the SEC to be "filed," but need not be distributed to security holders except upon specific request. To the extent that the two "annual reports" contain essentially similar representations and omissions, the "not filed" problem under Rule 14a-3 becomes irrelevant and should be deemed so as a matter of law by this court.

full and complete presentation of facts in corporate disclosure documents required by the federal securities laws. So far as the Exchange Act is concerned, those claims and remedies are based upon Section 14(a) and are neither expanded nor contracted by either Section 10 or Section 18 of the Act. As this court recently pointed out in Schlick v. Penn-Dixie Cement, supra, the policy behind Section 14(a) is specifically concerned with "fair corporate suffrage" and derived from a specific concern on the part of Congress with conflict of interest transactions, of which plaintiffs maintain a clear example is involved in this action. Stock Exchange Practices, S. Rep. No. 1455, 73rd Cong., 2d Sess., 74-76, 1934; S. Rep. No. 792, 73rd Cong., 2d Sess., 12, 1934.

So far as the SEC is concerned, it is clearly empowered by the Exchange Act to issue regulations designed to implement and effectuate the policies and purposes reflected in the statute. But the Commission clearly has neither power nor authority from Congress in the Exchange Act to frustrate, limit, restrict or repeal any provision of the Act. And it could not lawfully be delegated such legislative power by statute.

Thus the Commission has been delegated authority to require that certain disclosure documents such as proxy statements and annual reports be distributed by regulated "public companies" to securities holders and that such documents include certain information and omit certain kinds of statements. And that it has done under Section 14(a) in Regulation 14A.

But the SEC does not have either the authority or any duty conferred or imposed by Congress to frustrate the purpose of Section 14(a) by (A) requiring that a disclosure document like an annual report be distributed to shareholders and filed with the Commission and then (B) purporting to grant regulated corporations a license to commit fraud and deception in certain of those documents by placing them in a limbo category of documents "on record" at the SEC but not officially "filed" with it.

Plaintiffs maintain (a) that liability in a private action for materially deceptive statements and omissions in an annual report derives directly from Section 14(a) itself and not of necessity from any regulation promulgated by the SEC pursuant thereto and (b) that in Rule 14a-3(c) the SEC does not really attempt to limit the scope of liability imposed upon corporations in private suits under Section 14(a) but undertakes only to limit the intended scope of Regulation 14A and the Commission's power to enforce it. In other words, the SEC may be bound not to proceed against a corporation on the basis of an annual report contrary to the limits stated in 14a-3(c), since the SEC may limit itself and its staff as it may reasonably wish; but such a limit self-imposed by the SEC upon itself is no limitation upon a corporate security holder who sues for relief under Section 14(a) because he, among others similarly situated, was deceived and misled by false and distorted statements in an annual report.

Clearly any court asked to construe Rule 14a-3(c) as a regulation under Section 14(a) should construe the rule so as to enforce the policy and purpose behind the statute and not to frustrate or hamstring that policy and purpose to the clear detriment of the investing public.

Clearly the SEC should not be presumed to have promulgated a regulation which gives the appearance of protecting the investing public by requiring the issuance of annual reports and then makes a mockery of that appearance by giving the corporation the option not to have the proscription in Section 14(a) against fraud in proxy solicitations apply to fraudulent statements made in annual reports.

It is readily apparent that the "not filed" language of Rule 14a-3(c) was not intended when it was promulgated to inhibit or restrict in any way private actions for defects of disclosure in annual reports, since such private actions were not even recognized when the rule was first issued. Its purpose was and remains purely pragmatic and administrative, i.e., to free the woefully limited and overworked staff of the SEC from the obligation of reading, reviewing and making written comments upon annual reports as it does with respect to proxy statements. The staff is simply too small to read and review an annual report along with every proxy statement, so the two were put in separate categories, one "filed" (and therefore reviewed) and one "not filed" (and therefore not reviewed by the staff).

Thus an annual report may be filed by a company along with its proxy statement without the former being reviewed and commented-upon by the staff, but if there is a material misstatement or omission of any kind in the annual report, a private shareholder who received it in connection with the company's solicitation of his proxy may sue under Section 14(a) for violation of the statute and receive appropriate relief from a federal court under the doctrine and policy recognized by the Supreme Court in Mills.

It was plain error for the district court below to refuse to face and resolve this problem while at the same time ruling to dismiss the claims which it conceded to have raised the issue and presented it to the court for decision.

POINT V

THE RULING OF DISMISSAL BELOW IS IN OBVIOUS AND DIRECT CONFLICT WITH THE MEANING AND PURPOSE OF SECTION 14(a) AS AUTHORITATIVELY SET FORTH BY THE SUPREME COURT IN BORAK, MILLS AND AFFILIATED UTE CITIZENS AND BY THIS COURT IN THE RECENT SCHLICK CASE.

A cartoon circulated recently in many newspapers shows two canaries looking down at some rather fancy paper placed on the floor of their cage as a receptacle for droppings. One bird turns to the other and says, in a comment indicative of the economic times in which we live, "Oh, oh --- they've started using stock certificates."

Stocks included in the Dow Jones average have lost 40 to 60 percent of their value when compared with highs of a few years ago. Less prestigious "Big Board" securities have lost more than 70% of their value over that period; American Exchange shares have lost still greater percentages of value; and some authorities estimate that a majority of over-the-counter stocks have lost over 90% of their value in that time.

Clearly we are witnessing an across-the-board loss of faith in the national securities markets, in the managements of many publicly held corporations (even those that have posted huge profit increases recently), and perhaps in the U.S. economy and the will or capacity of those in power to manage it effectively for the good of the general public.

One aspect of this wide-spread loss of confidence as it involves the securities markets covered by the federal securities laws is a collapse in the credibility of corporate management. Along with the public at large, the investing public has simply ceased to believe what they are being told by those who run the corporations they have invested in. Their confidence in "management" is so low that dozens of companies have common stock selling <u>below</u> the liquidation value of physical corporate assets --- a circumstance that places a negative worth on the "going concern" value of the company and speaks loudly of the shareholders' view of management.

One reason for this state of affairs in the securities markets is that the small investor has come at long last, to realize what investment analysts have known all along: what they read in corporate press releases, advertisements, proxy statements, letters from corporate presidents, and annual reports is mostly propaganda created for financial "public relations" purposes and frequently just plain lies smudged over with vague and evasive words at crucial points to provide defensive explanations against direct charges of fraud and misrepresentation. The most frequent and successful means of such deception involves omission of material negative or damaging facts, since the facts omitted or disguised and their implications are usually known only to management, unnoticed by limited SEC review of filed documents, unknown by most investors, and not worth the inevitable cost and trouble for the small investor to bring suit to correct ---

no matter how serious the deceptive corporate disclosure may have been.

One reason for this sad state of affairs is the failure of the bar and the federal courts for many years to recognize and to implement in reported decisions the meaning and Congressional policy of Section 14(a) of the Exchange Act. Not until <u>Borak</u> in 1964 did the Supreme Court give significant attention to this problem. The lower federal courts completely ignored the meaning of that decision. Six years later, the Supreme Court restated the importance and meaning of 14(a) in its 1970 <u>Mills</u> decision. For more than three years, the meaning of that decision went largely unrecognized among the federal bar and judiciary, despite reiteration by the Supreme Court in <u>Affiliated Ute Citizens</u> [406 U.S. 128, 151 (1972)].* One indication of that state of affairs is reflected in this Court's recent <u>Schlick</u> decision in which it was called upon to correct an almost total failure by the court below to understand either the purpose of 14(a) or the difference between a claim under that statute and one under Section 10(b).** The close parallel

---

* Cf. <u>Wechsler v. Southeastern Properties, Inc.</u>, ______ F.2d ______ (2d Cir., 11/4/74), CCH <u>Fed.Sec.L.Rep.</u>, Curr. Vol. ¶94,857 (Discusses significance of <u>Mills</u> in the context of denial of an award of counsel fees.)

** See, <u>Sonesta International Hotels Corp. v. Wellington Associates</u>, 483 F.2d 247, (2d Cir. 1973) (a tender offer case); <u>duPont v. Wyly</u>, 61 F.R.D. 615, 629 (D.Del., 1973, Stapleton, J.) ("The theory of corporate democracy which underlies the private right to enforce Section 14(a)...is incompatible with the notion that a shareholder has an enforceable federal right to honest proxy materials only when transactions approved by a shareholder vote in which he was misled...[have] resulted in economic injury to him," citing <u>J.I. Case Co. v. Borak</u>, 377 U.S. 426 (1964).)

between the reasoning of the lower court in Schlick and the opinion of dismissal below in this case is obvious and explained above. No further explanation of that obvious error is necessary here.

The court below reasoned something like this: "Since I can't see money damages as appropriate relief and am unwilling to issue an order requiring the issuance of corrected proxy materials and the holding of a new corporate meeting and election, there is no remedy available from a federal court for any securities law violations that may have been committed in this case; and, since no easy remedy is available, the court will simply dismiss the first two claims and not bother to determine whether or not there is merit to those claims on the question of liability." Thus the district court conveniently turned on its head the maximum of equity that "there is no wrong without a remedy." Here the reasoning was that finding no easy remedy the court would not bother to decide whether a wrong had been committed or not. It is understandable why no authority was cited for this bizarre legal reasoning.

The reasoning of the court below in this case would eliminate most of the intended remedial effect of Section 14(a) and make a mockery of the federal appellate decisions in Borak, Mills, Affiliated Ute Citizens and Schlick if left to stand unreversed by this Court. Below, Judge Griesa reasoned (1) that unless readily discernible, measurable and awardable monetary damages are alleged to have resulted from alleged

deceptive disclosure in proxy materials, then the possibility of other appropriate equitable relief need not be seriously considered and the complaint must be dismissed even if false disclosure was made to the shareholders and a valid claim of statutory violation and liability was presented and (2) that unless a federal court ruling on 14(a) violations in annual meeting proxy materials is obtained before the next annual meeting, then holding of the next annual meeting, like the recent pardon of Richard Nixon, wipes the legal slate clean of all claims of federal statutory violation by fraud in prior proxy materials by rendering the relevant claims "moot."

That reasoning makes a mockery of Section 14(a) and displays substantive ignorance of Borak and Mills (despite citation thereof by both sides). If accepted by this court and followed by other federal courts it would grant to corporate managements by judicial interpretation a qualified but extensive and dangerous license to commit fraud and deception upon their investing stockholders and then escape liability through a giant legal loophole made available by judicial and procedural delay. Public disrespect for law, the courts and the securities markets could only be substantially increased as the consequence of the acceptance of such a reading of Section 14(a) and the proxy rules. (By way of contrast with the refusal below to review the merits of plaintiffs' claims of defective disclosure, see Denison Mines, Ltd. v. Fibreboard Corp., ______ F. Supp. ______ (D.Del., 11/19/74, Stapleton, J.), CCH Fed.Sec.L.Rep., Curr. Vol.,

¶94,869, in which, despite the severe pressures of time involved, the court carefully considered the merits of the claims stated of liability for statutory violation.

Judge Knapp succinctly and correctly summarized the meaning of 14(a) (which appellants urge and the court below failed to recognize) in a recent decision, Lewis v. Dansker, _______ F. Supp. _______ (S.D.N.Y., 11/11/74), CCH Fed.Sec.L.Rep., Curr. Vol., ¶94,862:

> "...Upon finding a violation of the proxy rules, a court should be 'alert to provide such remedies as are necessary to make effective the Congressional purpose.' J.I. Case v. Borak (1964) 377 U.S. 426, 433. The courts have repeatedly emphasized their inherent equitable power to fashion whatever remedy the circumstances dictate. Mills v. Electric Auto-Lite (1970) 396 U.S. 375, 387, In re Ceasar's Palace Securities Litigation (S.D.N.Y. 1973) 360 F. Supp. 366, 392. They are not limited by the plaintiff's prayer for relief, but may instead grant damages where rescission was requested, or an injunction where an accounting was sought. Cf. J.I. Case v. Borak, 377 U.S. at 433-434."

In Bailey v. Meister-Brau, Inc., ______ F. Supp. ______ (N.D. Ill., 6/5/74 & 9/27/74, McLaren, J.),* the district court was presented with a proxy situation involving a proposed merger in which, as in the present situation, corporate management (controlling directors) owed conflicting duties to parties on both sides of a proposed corporate transaction and failed to make adequate disclosure of the resulting conflict of interests

---

* CCH, Fed.Sec.L.Rep., Curr. Vol., ¶94, 337

to proxy recipients who had a direct interest in the result. After trial, liability for violations of fiduciary duties imposed under the federal securities laws (as well as state corporate law and equity) was imposed upon the corporate officers and directors who failed to tell the truth and to treat with fairness and equity the security holder whose interests stood to be greatly affected by corporate action taken by them. There, as here, there was a complete failure to consider in any rational or defensible way the conflicting corporate interests held in balance by corporate management. In Bailey as in the present case, the conflict of interest problem and the appearance (as well as the substance) of arbitrary and inequitable management behavior could have been significantly reduced by resort to advice from an independent expert, such as the one used in Dennison Mines, supra. Such action was suggested by plaintiffs before the computer sale in this case and arbitrarily rejected by Dasa's management, thus greatly and avoidably complicating the present case. Cf. Tanzer Economic Associates v. Haynie, _______ F. Supp. _______ (S.D.N.Y., 11/20/74, Frankel, J.),* where the court ruled under 14(a) on the handling in proxy materials of an expert opinion.

---

* CCH Fed.Sec.L.Serv., Curr. Vol., ¶94,873.

CONCLUSION

For the reasons set forth above, each of the decisions below here appealed-from should be reversed and remanded for appropriate corrective action by the district court.

Dated: New York, N.Y.
February 10, 1975

Respectfully submitted,

BREWER & SOEIRO
257 Park Avenue South
New York, N.Y. 10010
(212) 777-4010

Of Counsel:

Bradley R. Brewer

AFFIDAVIT OF SERVICE BY MAIL

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

Jack N. Weber, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 231 Thompson St., NYC. That on the 10th day of February, 1975, deponent served the within Brief of Appellants upon Jacobs, Persinger & Parker (attorneys for Appellee-DASA Corporation) and Breed Abbott & Morgan (attorneys for Appellee-Arthur Andersen & Co.) at 70 Pine Street, New York, N.Y. 10005 and One Chase Manhattan Plaza, New York, N.Y. 10005 respectively, the addresses designated by said attorneys for that purpose by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States Post Office department within the State of New York.

Jack N. Weber

Sworn to before me, this
10th day of February, 1975

Bradley R. Brewer

BRADLEY R. BREWER
Notary Public, State of New York
No. 31-0411790
Qualified in New York County
Commission Expires March 30, 1975